January 15, 2016

Notice of Written *Ex Parte*

Marlene H Dortch, Secretary
Federal Communications Commission
445 12th Street, SW
Washington, DC 20554

RE: *Connect America Fund*, WC Docket No. 10-90

Dear Ms. Dortch:

Over the past year Shawnee Telephone Company has closely followed the progress of the FCC as it adjudicates the above-referenced *Connect America Fund* proceeding. Shawnee, like most other telecommunications industry participants, believes there is no doubt that the reforms to the universal service distribution mechanism will result in some carriers experiencing increases in support while others experience reductions in support. Shawnee acknowledges that some degree of reform is necessary to achieve the goal of the White House, Congress and the Commission to expand broadband availability to customers in high cost rural areas at service and rate levels comparable to those enjoyed in urban areas.

However, Shawnee is concerned that the intense scrutiny on the mechanics of the distribution proposals overshadows other important factors that must be accounted for in the Commission's final resolution of the proceeding. Virtually all parties acknowledge that reforms are necessary to promote the expansion of broadband availability to customers in rural areas where such service is not commercially viable without support. Consistent with this goal, Shawnee and some other rural carriers are at the forefront of the industry's efforts and already have accomplished the buildout of broadband capable networks over the last decade and, in doing so, have taken on large amounts of debt. In order to continue to provide broadband to rural customers, operate complex telecommunications networks and service the debt that financed their construction, these carriers depend on continued universal service funding. The successful roll out of fiber to the home (FTTH) networks in rural areas is an indication that for some carriers the current universal service support mechanisms have functioned well in meeting the broadband deployment goals of the Commission. Despite the successful efforts of these rural carriers that are leading the way to expand broadband availability to the nation's rural areas, it is not difficult to imagine that the significant reductions in support for an individual carrier that could result under certain proposed mechanisms would lead to an inability to sustain the operation of its broadband network.

One scenario included in the A-CAM 4.2 Illustrative Results published by the Commission, Reference Report 4.2, would eliminate support in rural census blocks where the carrier has already built-out FTTH. Because of this limitation, roughly 100 study areas would experience reductions in support from 2014 levels. A proposal that takes away the support that was necessary to build and is equally necessary to continue to operate the broadband capable networks that all acknowledge are critical for the economic survival of rural America because it is already built is inconsistent with the goals it claims to advance. Customers in these areas would be penalized because the serving carrier is ahead of the curve and has already done what the FCC is attempting to induce all other carriers to do. The 2011 *Transformation Order* explicitly stated that the "reforms will help ensure rate-of-return carriers retain the incentive and ability to ***invest and operate*** modern networks capable of delivering broadband as well as voice services, while eliminating unnecessary spending that unnecessarily limits funding that is available to consumers in high cost unserved communities." (Emphasis supplied)[1] Limiting support to areas that are behind the curve would be devastating to future incentives to continue to invest in and operate the next generation of advanced network facilities.

Reductions in support due to changes in distribution mechanisms or from limiting support to only those census blocks that do not yet have FTTH networks essentially would undo the accomplishments of these carriers that spearheaded the industry efforts by reducing broadband availability due to the loss of service for rural customers. As NTCA stated in its December 22nd, 2015 letter to the Commission, "each kind of network – those already built and those still to be built – is equally important to the mission of universal service, and each kind of network requires sufficient and predictable support..." Shawnee agrees with NTCA's statement and the Company is very concerned that a significant reduction in support will make it difficult if not impossible for it to sustain the broadband network it has already built. The Company thus requests that the Commission take steps to avoid throwing "the baby out with the bathwater" as the specific mechanisms for universal service disbursements to rural ILECs are finalized and adopted.

These comments address what Shawnee Telephone Company considers to be a serious omission in the proposed mechanisms for universal service reform considered to date in the *Connect America Fund* proceeding. Specifically, the proposals largely ignore the need to safeguard the continued availability of broadband for communities and customers served by those rural carriers that already have invested in advanced broadband networks and that have assumed the associated risks while heeding White House, Congressional, and Commission calls to deploy networks capable of advanced broadband services to customers in rural areas.

While the Commission has published illustrative results for several runs of the A-CAM model that provide insight into the like impact of the model-based option, there still exists a considerable lack of clarity regarding the potential provisions and results under the legacy, or bifurcated, option. This absence of specific information regarding the

[1] *Transformation Order* at ¶ 288.

legacy option leaves Shawnee and other similarly situated RoR ILECs in the dark with respect to the amount of high cost support they would receive to continue to provide broadband service to customers under such an approach. However, an analysis recently performed by NECA estimates that between 45% and 59% of the companies with at least 75% deployment of 10/1 broadband will lose support, with between 6% and 9.56% of those companies losing more than 50%. While these values are estimates based on a series of assumptions, they indicate that there is a real possibility that support to rural areas where broadband is already available will be cut to the point where there is doubt that broadband will remain available. Shawnee's proposal, as described below, is intended to provide a backstop to ensure that high cost support will remain sufficient for those companies that already have built out advanced broadband networks in furtherance of the Commission's stated goals of providing reliable, quality broadband service.

In an ex-parte letter dated December 4, 2015, Home Telecom asked the Commission to consider adopting a "simple, specific stability mechanism to ensure all companies have the certainty of a reasonable transition to any new universal service mechanism." Shawnee fully agrees that it is necessary to include in any adopted reforms a mechanism designed to ensure that support remains sufficient and predictable for all carriers, especially those that are at the forefront of the industry effort to accomplish the FCC's goals of providing broadband service to customers in rural areas. To facilitate its build-out of a broadband capable network over the course of the last decade Shawnee has taken out tens of millions of dollars in USDA RUS loans and, as a consequence, is dependent upon consistent and sustainable support in order to service that debt and to operate a broadband network capable of providing reliable, quality service on par with that available in urban areas. [NOTE: Shawnee overcame considerable challenges in its broadband network deployment efforts and successfully completed the broadband build-out in a study area that encompasses a national forest covering 5,000 square miles and that exhibits a density of under 11 locations per square mile].

As mentioned previously, Shawnee is not alone in having such concerns. Home Telecom proposed that reductions in universal service support be capped at 5% per year. Assuming a ten-year term for the CAF Phase II program, under the Home Telecom proposal a carrier could receive as little as 50% of its current support in year ten.[2] It is almost certain that an eventual 50% reduction in support, along with the impact of the reductions experienced in the previous years, would jeopardize a company's ability to sustain the operation and financing of its broadband network. Consequently, Shawnee believes that the Commission should consider bolstering the Home Telecom proposal through a limit on the overall reduction to a single carrier to 20% of the current distribution.

As an alternative, Shawnee asks the Commission to consider an earnings-based support stability mechanism. Under the earnings-based alternative any carrier that

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[2] Support in year 10 could be 50% of the current level if the 5% reduction limit is applied to the current amount each year or 59.87% of the current level if the 5% were applied to the previous year's support amount.

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would receive less than its current level of support, either under the CAF-II model-based support mechanism or under the eventually adopted legacy approach, would be allowed to invoke an earnings review. Under the earnings review the company's earnings would be measured on a total company basis using the same fully-distributed cost methodology employed for the FCC's Form 492 reporting. The earnings review process would identify those companies that are significantly affected by a reduction in support under any chosen option.

More specifically, the earnings-based stability mechanism would come into play when a reduction in a carrier's high cost support results in total company regulated earnings that are 50 basis points or more below an authorized level in a given year. When this trigger measure is met, the carrier's support for the subsequent year would be increased to either an amount that would enable the carrier to earn a return equal the authorized level or to the frozen support amount -- whichever is lower.[3] The goal of this proposal is not to protect a given level of support from the impact of reforms, rather, it is intended to ensure that support continues to be sufficient to provide the level of earnings necessary for the continuing ability to operate the advanced broadband network and to meet the debt service requirements of the associated plant investment. The proposal is similar in concept to the lower formula adjustment mark that price cap carriers operated under for many years. Likewise, the proposal is not intended to reflect a guaranteed level of earnings. Instead, the addition of a backstop mechanism is meant to preserve the opportunity of rural carriers to earn sufficiently to provide sustainable service at comparable prices.

The existence of the Federal Universal Service Fund is an acknowledgement that rural carriers cannot provide customers in rural areas sustainable service comparable to that enjoyed in urban areas without support. The Commission has acknowledged more than once that predictable and sufficient support to rural areas is the only way rural carriers will have an opportunity to earn a reasonable return. Large reductions in support to any one area will result in one of two things; 1) that the existing level of support was too high and reducing it will not financially harm the carrier and/or will not lead to a loss or degradation of service to customers or; 2) the existing level of support was reasonable and any large reduction will be harmful to the company and ultimately to its customers. The Shawnee proposal is intended to mitigate the second possibility. As the authorized return is the minimum level required for a company to cover its costs and earn a return sufficient to continue to attract capital, large enough reductions in support will guarantee that a carrier will continue to under earn year after year.[4] In such cases,

[3] The current authorized return is 11.25% while the A-CAM model includes a 9.5% cost of capital. Under the Commission's rules, the authorized level may be changed as a result of a rate of return re-prescription proceeding.

[4] Federal Communications Commission, Wireline Competition Bureau Staff Report, *Prescribing the Authorized Rate of Return: Analysis of Methods for Establishing Just and Reasonable Rates for Local Exchange Carriers*, WC Docket No. 10-90, May 16, 2013. (*Staff Report*) at ¶6. Please see https://apps.fcc.gov/edocs_public/attachmatch/DA-13-1111A1.pdf

continued availability to rural customers of broadband service at rates comparable to urban areas is not likely.

From a budgetary perspective, Shawnee's proposed earnings-based stability mechanism would not be disruptive to the course being pursued by the Commission and the rural associations. As mentioned previously, the Shawnee proposal will not increase the amount of funding currently received by any carrier and, in some cases would provide less than current funding where the incremental funds would bring the carrier up to an authorized earnings using less than current high cost support. While the proposal's implementation potentially would cause shifts in funding to those carriers that opt for and qualify for the backstop provision, there is no indication that a significant portion of total funding would be affected.

The A-CAM model Illustrative Results recently published by the Commission are informative on this issue. One A-CAM option examined redirected support from study areas already with high existing broadband deployments to those study areas with low deployments, the results for which revealed that there are roughly 100 study areas that would experience reductions in 2014 support under this option. In view of the explicit funding cap incorporated into the Shawnee proposal, the reallocation of funds related to these roughly 100 study areas would likely represent a very small portion of the $2 billion budget.

Due to the aforementioned lack of specificity regarding the legacy/bifurcation option, Shawnee is not yet able to provide a meaningful estimate of the number of companies that might take advantage of its backstop option. However, the Company expects that the number of companies likely to be affected would be relatively small in view of the bifurcated approach which would apply existing mechanisms for legacy investment and updated mechanisms for new investment. Under the bifurcated approach, the support for initial periods would largely reflect the current legacy-based mechanisms and thus would be unlikely to trigger widespread use of Shawnee's backstop option. As new investment begins to dominate going forward, carriers will be increasingly better able to tailor investment decisions and to adjust operations in a manner which will enable them to maintain the levels of earnings necessary to sustain their broadband networks. Under these likely scenarios the relative portion of high cost reallocations related to the backstop option will be relatively small.

Although the number of companies affected under the Shawnee proposal may be relatively small, it is again important to note that these carriers have been at the forefront of the industry effort to accomplish the Commission's stated goals regarding broadband deployment. These companies must not be penalized for the early implementation of forward-looking investment strategies in keeping with the Commission's policy goals, particularly when significant reductions of support would threaten the viability of advanced broadband networks already in place in clear contravention of these goals. To this end, the Shawnee proposal is intended to ensure that the reforms incorporated into CAF Phase II do not unintentionally lead to a situation where attempts to stimulate broadband deployment do harm to customers in those areas where broadband is already available.

Shawnee would like to acknowledge the Commission's efforts to this point in advancing service in rural areas and for its attention to this correspondence

Pursuant to Section 1.1206 of the Commission's rules, a copy of this letter is being filed via ECFS.

Sincerely,

Matt Johnson
Vice President – Government Policy
Shawnee Telephone Company

cc: Stephanie Weiner
Rebekah Goodheart
Nickolas Degani
Travis Litman
Amy Bender
Matthew DelNero
Carol Mattey
Alex Minard

Proposed Plan to Restrict the Reduction in Universal Service Reductions Based on an Analysis of Earnings

I. **The Proposal to Restrict Reductions in Universal Service Distributions Without a Review of Earnings**

a. The adjusted USF distribution mechanisms likely to be adopted by the Commission no doubt will significantly impact many of the 800+ RoR carriers that depend on Universal Service support for their continued operation

b. While many options and detailed proposals for reform mechanisms have been discussed and analyzed over the course of this reform proceeding, little attention has been paid to the potential impact on the financial viability of individual carriers should their support be reduced

   i. Approximately half of all RoR carriers would see reductions in support under the model

   ii. It is likely that many carriers who have already built-out broadband capable networks could see reductions in support even under legacy options if support is re-directed from them to carriers with low broadband deployment rates, as proposed

   iii. Carriers that have already built out their broadband capable networks may see support fall significantly under the legacy option

   iv. There has been little or no discussion of steps to be taken to insure that these carriers continue to earn sufficient revenue, including support, to sustain their operations and to meet debt service requirements

c. An additional option should be made available to RoR carriers to ensure that support reductions do not imperil the carriers' ability to continue to build out its broadband network or maintain the network already in place, i.e., to ensure that support continues to be sufficient to extend and operate advanced broadband networks

   i. It is not the Commission's intention to increase broadband deployment through reforms of the USF program in a manner that would render existing broadband networks unsustainable

   ii. The Universal Service Fund is intended to support both the construction and operation of telecommunications networks

d. How is sufficiency determined? The traditional metric to measure a regulated firm's financial health is earnings on net investment and we propose that an earnings test be included as an option to prevent earnings from falling below the authorized level due to a reduction in high cost support. For carriers electing the earnings test option:

i. No reduction to current support should imposed on a carrier whose earnings are 50 or more basis points below the current authorized cost of capital (currently 11.25%)
ii. Any reductions in support will be limited to the amount which brings the carrier's earning's down to 50 basis point below the currently authorized level.
iii. Expenses in the earnings test calculation will reflect all caps imposed by the FCC on RoR carriers including, but not limited to, those on corporate operations expenses and the $250 overall support per line per month
iv. Carriers electing the earning test option will be subject to all build-out requirements imposed on those adopting model-based support
v. To be eligible for the earnings test option a carrier must be in compliance with the annual voice and broadband price floors established by the Commission
vi. Carriers will be eligible to select the earnings test option annually over the period CAF Phase II is in operation

e. The earnings test will be performed based on data similar to that used in the current Form 492 filings, but the showing would be expanded to include total regulated results
   i. Data filed with NECA to be used
   ii. The earnings test calculation would be based on the most recent calendar year's revenue, including federal support, and expenses
   iii. Expenses used in the calculations for the earnings test will include expense caps for universal service specified in Part 54 of the Commission's rules
   iv. The Earnings Test Option is available only to ILECs where high cost support under CAF Phase II is less than current; this proposal is not intended to address cases where current support may not be sufficient
   v. Average Schedule Companies not eligible for Earnings Test Option

f. The availability of the earnings test option will not cause additional funding over and above the budget
   i. No carrier electing this option will receive support in excess of the current amount received